

AUSTRALIAN DEMOCRATS SUPPLEMENTARY REPORT

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Background

It is important to understand the historical context leading to the current regulatory framework in which the petroleum industry operates today.

Prior to 1980 it was recognised by the then government that considerable regulation was required to stabilise the retail petroleum industry. As a consequence, the Petroleum Retail Marketing Franchise Act 1980 (PRMF Act) and the Petroleum Retail Marketing Sites Act 1980 (Sites Act) were enacted. These acts were designed to provide Lessee service station operators, with certain basic rights and protection in their relationship with Lessor Oil Companies. The Sites Act, limits the number of retail sites that each of the major Oil Companies may directly operate throughout Australia. The Acts are complimentary in operation.

The spirit of these Acts was to remove control of retail petroleum prices by restricting the number of Company owned or controlled sites, leaving the remaining sites to be owned and operated by independent businessmen or franchisees. This ratio (approximately 5%) was intended to prevent monopolistic Oil company holdings and inevitable price control, for the protection of the consumer.

The PRMF Act was designed to protect independent Franchisees and Lessees from the previously exhibited predatory actions of the Major Oil Companies. The intention of this Act was to facilitate a free market place, resulting in legitimate competition between independent Franchisees, Lessees and Oil Company owned sites and to provide a more competitive market place for the Consumer.

During the debate leading to the enactment of this legislation, all major Oil Companies vigorously opposed, lobbied and campaigned against any form of the introduction of this type of legislation. Its effects on Oil Company ownership, control and pricing are evident. Since that time Oil Companies have maintained a position of deregulation, and non Government control, to the present day. Despite numerous inquiries into the petroleum industry, the Companies have steadfastly refused to move from their stated preferred position.

Prior to 1989 it was generally accepted that Service Station proprietors were in a relatively profitable situation, not under severe company control, but with a fair return on capital invested and in proportion to the personal effort involved.

At this time Shell Australia developed a Franchise package and forced it upon its lessees. This franchise has since proven to be an intricate tool to bring about complete compliance, servility, and financial dependence upon Shell.

In order to retain this dependence and lost control in the market place, Shell Australia have systematically employed a series of tactical policies designed to achieve their preferred position (total ownership and control of all Shell sites) and are in brief, as follows:

- Introducing the Franchise, Shell assured all, that some would pay only slightly above their current rental, whilst the majority would not suffer any rental increase. The reality has been a doubling of royalties (rent) since its inception.
- Changes in post franchise competitive support has resulted in severe financial losses allowing Shell to progressively gain ultimate control by financially underpinning Franchisees at their total discretion. This contrived support system has resulted in Franchisees being unable to meet the unconscionable increases in royalties (rent) after meeting basic running expenses.
- The introduction of margin capping on Shell fuel credit card, applied at two levels, has forced financial losses, as acceptance of this credit card system is non discretionary.
- Franchisees are required to pay COD for fuel deliveries, in an established fuel discounting environment, with Shell rebates being held in abeyance for periods exceeding three months which results in the Franchise being the financial source of the exercise. This places significant financial strains on the business owner in an environment where there is already only a small profit margin.
- Since franchising was introduced, Shell have consistently taken substantial monetary payments and discounted percentages from every recommended trade supplier of the franchise, to the franchisee's financial detriment, effectively capping discount structures with these companies.
- As a result of this contrived environment, franchisees have become vulnerable, to unwanted but necessary offers to purchase their businesses by Shell.

There have been substantial changes in the retailing arm of the industry over the previous 10 years. This period has seen significant increases in the level of excise that has been collected by the government. There have been significant decreases in profitability both at a retail and wholesale level, and there has been a significant increase in the number of large non-refining petroleum marketers such as Liberty and Gull. These changes mean that the industry itself is significantly different to the operating environment some 20 years ago when the two Acts were passed.

This is not to say that these Acts are now totally redundant. One of the major reasons that the Acts were first passed was to prevent the major Oil refiners from creating strict vertically integrated operations and hence creating an oligopolistic market resulting in a small number of operators garnering significant market power and increasing the possibility of retail collusion.

The ACCC is proud of its efforts in supporting Liberty oil in its period of growth. As such it is unlikely that the ACCC is going to admit that it has failed in its ability to establish a retail market that offers healthy competition. As a consequence of this the ACCC has stated that it will offer no contest to the repeal of the Sites Act. It sees no problem in regard to the major Oil companies operating without retail restriction. At the same time however it did offer concerns about the ability of the policing of the Oil companies' statements of intent that would be given as a result of any agreement to the repeal of the Sites Act.

Multi-site franchising has been investigated in SA, Victoria, and now by the federal parliament. All these inquiries have been inconclusive in proving that this method of retailing is un-competitive. It is not unreasonable to assume that oil companies are looking for alternatives in the methods by which they are structuring their retail operations due to the smaller margins available. Mobil have gone down the path of having a smaller number of sites grouped together. BP have gone a step further and developed a range of 15 sites grouped together under Multi-Site franchising agreements. Shell on the other hand have MSF operations that include up to and in some cases over 50 retail outlets. This means that the petroleum retail market is no longer an area of opportunity for small business operators in the Shell Oil company.

The Democrats are of the view that there is genuine fear that all Oil companies will follow suit with Shell. They may not set up large MSF operations, however they may set up, as Mobil already is, massive equity operations while the Sites Act still remains.

The tide of change for the Industry has already begun to rise and changes that are put into place must seriously look at what is in the interest of the consumer firstly and then secondly what is in the best interest of the business operators in this industry. This view is one that must be considered in the here and now, but importantly what it will do to shape the industry in the future.

Fitzgibbon Bill

The Issue of partial separation of fuel supplies from tied fuel agreements under a franchise arrangement, according to the ACCC would have:

...a limited impact on the level of competition in the wholesale fuel market. This is because branded franchisees of the refiner/marketers only account for around 30% of all retail service station sites in Australia.¹

The ACCC went on to say that it could:

...also be further diminished in the case of low volume service station sites that are more prevalent in country areas.²

¹ Correspondence from ACCC to the Senate Economic References Committee Inquiry into *the Provisions of the Fair Prices and Better Access for All (Petroleum) Bill 1999 and the practice of multi-site franchising by oil companies* dated 28th April 2000, page 2.

In the face of the loss of price support and the increases in the rental charges that the oil companies would place upon franchisees, it is highly unlikely that, even if given the opportunity, they would take up the option of the partial break in the fuel agreements.

The MTAA have argued, and rightly so, that the tied fuel agreements under a system of price support being taken up by retailers, this adds a serious level of complexity to the industry. It is this level of complexity that creates the current environment of non-transparency from the wholesaler to the retailer.

In all the industry is suffering heavily from the fact that there is a very small margin available to all those through the chain of operations. Fuel refiners are looking for certainty in relation to the supply of their fuels, and retailers are looking for a competitive position in the retail market.

Evidence was given by Mr Harris to the first hearing that sites in metropolitan areas are now operating for the majority of each month at a level that is requiring them to be under a price support arrangement. There should be considerable concern as to the level of market influence that the Oil companies actually do have on both the competitiveness of Sites and the price in the retail market.

The issue of competitiveness of sites is an important one, not from the perspective of the market as a whole, but from the perspective of individual operators. It is of concern to the Australian Democrats that there has been allowed to develop, the situation whereby oil companies have such influence over the livelihood of individual franchisees. This influence appears to have developed to the extent that if a company were unsatisfied with a particular franchisee as a result of a 'clash of personalities' they could effectively wipe out their business operation.

Having these arrangements as the status quo as opposed to some other structure leads me to believe that the ACCC and the government should be taking more action to address the might of the oil majors. The ALP and the MTAA believe that Fitzgibbon's private members bill is the answer to this situation.

The Australian Democrats share the ACCC's view that the Bill will make little difference to both wholesale competition and also to increased transparency in the industry. What is required however is a systemic change that will bring about lasting structural alteration within the Industry.

The Democrats would argue against the idea that deregulation would create increased levels of efficiency within the industry. The Democrats would also argue that total deregulation would create an environment within which the major Oil companies would not only be able to be totally vertically integrated, but would actually exercise this option.

² Ibid

Current trends in the market show that major Oil companies are forming either groups of sites, known as multi-site franchises, or setting up equity arrangements that directly operate large numbers of sites.

The Oil companies have and will argue that this has resulted due to market evolution and shrinking margins. The MTAA have and will argue that this change is motivated by a desire to negate the Sites Act.

It matters little who is right and who is wrong, the fact remains that Oil refiners are taking an increased involvement in the retailing sector of this market.

It is the belief of the Australian Democrats that this is unhealthy and measures need to be put in place that will create a healthier climate for petroleum retailers.

I would reinforce the conclusions drawn by my colleague, Senator John Woodley, in the minority report we presented to the Inquiry into the Petroleum Legislation Repeal Bill 1998, which reported in March of last year. The Inquiry was conducted by the Senate Rural and Regional Affairs and Transport Legislation Committee.

Our conclusions therefore are consistent with the other inquiry, they being:

- 5.1 The issues for the petroleum industry are vertical and horizontal integration, open access to terminals and protection of the rights of individual operators. The correct mix of regulation of each of these areas should result in increased competition and profitability, and better pricing practices. It would also result in a beneficial end to the market dominance of the oil majors in the wholesale and retail sectors.
- 5.2 The Australian Democrats agree with the majority report to the extent that it recommends the retention of the Franchise Act until the completion and tabling of the OilCode in the Parliament as a regulation pursuant to Part IVB of the *Trade Practices Act 1974*.
- 5.3 We agree that an appropriate access regime should be implemented. The description by the majority of the regime is an appropriate starting point for the development of an access regime.
- 5.4 The Australian Democrats do not agree with the majority in its recommendation that the Sites Act be repealed after two years unless the Senate passes a resolution adopting a recommendation of a committee of the Senate that the Act not be repealed. This is an unusual mechanism. The ordinary procedure would be for the Sites Act to be left in place and for the Senate to repeal that Act after two years (or any other period) if a Senate Committee recommended that that was appropriate.
- 5.5 The Australian Democrats agree that there should be a Parliamentary review of the access regime after 18 months of operation.

The Australian Democrats are pragmatic enough to appreciate the fact that neither the Coalition or the ALP have the political will to enact the above changes that we see as necessary to bringing about more competition in the distribution and retail of petroleum products in Australia.

The practice of multi-site franchising is one that fundamentally changes the dynamics of the industry. It is one thing to develop efficiencies as a result of larger buying power but it is another thing entirely to bring about changes that would see a State's petrol stations operated almost entirely by one company.

The balance of market power must not be allowed to fall too far in the direction of the oil companies, or rather the MSF operations within these oil companies. To do so means that small suppliers in the industry have little room to be able to operate a viable and profitable operation.

The small businesses in the retail petroleum industry generally deliver the highest levels of employment and return to many smaller communities.

Many smaller service stations have a symbiotic relationship with other business in the surrounding area, particularly in smaller suburban shopping centres.

Shops and other small businesses with a petrol station in the vicinity have reported significant declines in profitability when a petrol station has closed temporarily. Profitability has gradually increased again after the local petrol station has reopened- but the loss to other businesses can take a long time to recover and indeed be 'the straw that breaks the camel's back' for some.

It is for this reason that the Australian Democrats have concerns with regard to the operation of Woolworths in regional communities. Research from Australian Catholic university has shown that once Woolworths has settled into a market with its fuel stations, it has done little to offer lower fuel prices.

This reaffirms the Democrats belief that while we see the need to move forward in relation to some change within the industry, the Australian Democrats believe that the Sites Act needs to remain for a period of 5 years. The existing legislation needs changing to enable an increased level of Commission agency agreements, and a review of the level of company operated Sites. However the Australian Democrats believe that the practice of Multi-site franchising should be limited in its numbers at this point in time.

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